

ESTIMATED LOSS FORMULA

ABOUT THIS FILE

April 1999

This electronic file contains guidance concerning the estimated loss formula. The basic document on the estimated loss formula is the Institutional Review Branch (IRB) procedures memoranda 92-3 issued on March 18, 1992.

On April 3, 1992, a memorandum correcting certain items in the worksheet included in IRB 92-3 was issued. Also, a second memorandum updating the interest and special allowance rates in the IRB 92-3 worksheet was issued on April 20, 1992. Neither of these memoranda are included in this file. However, the version of the worksheet included in this file reflects the updates of both memoranda.

MEMORANDUM

UNITED STATES DEPARTMENT OF EDUCATION

WASHINGTON, D.C. 20202-_____

IRB-92-3
March 18, 1992

TO : Institutional Review Branch Chiefs
DFO, Regions I - X

FROM : Clarence Hicks, Chief
Institutional Review Branch, DAPR

SUBJECT: Method of Calculating the Actual Loss to the Department
for Ineligible Stafford and SLS Loans

We are providing the attached procedural memorandum for guidance in calculating the estimated actual loss to the Department for ineligible Stafford and SLS Loans. In addition, Attachment A provides a worksheet to illustrate the formula to be used. Software to simplify the calculation of the formula is under development and will be provided to the Regional Offices within the next few months.

We believe there are many advantages to using the new actual loss formula. This formula will strengthen the Department's assessment and collection of program review liabilities for ineligible Stafford and SLS Loans. Please review the introduction to the procedures memorandum for more information. A few changes have been made in response to the Regional Offices' comments. Some of the issues raised are addressed on Attachment B.

Combined with appropriate informal fines, this method will not decrease the overall penalty to schools for improper administration of the GSL programs. We believe, in many cases, the new formula will actually increase the Department's net recoveries, and remove the argument of some schools that purchasing loans forced them into bankruptcy. The attached procedures memorandum gives additional background and a detailed description of the calculation.

The formula is flexible and can be adapted easily to specific situations. The regional staff have some discretion in its use. It may not be in the Department's best interest to use the formula in every situation.

If you have questions, please contact Lynda Folwick of my staff at FTS 458-7405.

Attachments

DIVISION OF AUDIT AND PROGRAM REVIEW	EFFECTIVE DATE IMMEDIATELY	IRB 92-3
SUBJECT: Actual Loss Calculation for Ineligible Stafford and SLS Loans		PAGE 1 of 5

PURPOSE

To provide guidance and a formula for a simplified method of calculating the estimated interest, special allowance, and default losses to the Department for ineligible Stafford and SLS Loans.

SCOPE

These procedures are to be used only for estimating the Department's actual losses from ineligible Stafford and SLS loans identified by the Department for which an institution would otherwise have been required to purchase the promissory notes. **This method cannot be used to calculate the Department's losses for unpaid or late refunds, fraud, or forgery.**

This method does not incorporate a penalty; it estimates the Department's actual losses from interest, special allowance, and defaults only. When appropriate, the reviewer should also propose informal fines per occurrence or recommend that the Program Compliance Branch initiate formal fine action commensurate with the seriousness of the institution's violations.

BACKGROUND

Regulations require institutions to repay the Department for liabilities they incur in programs administered by the Department. Because Stafford SLS Loans are made with funds provided by lenders and are guaranteed by State or private non-profit guarantee agencies, the liability owed to the Department for improperly made loans is not clearly defined. At least, it should include default claims reinsured by the Department and any interest and special allowance paid to lenders for the ineligible Stafford loans.

When ineligible loans are identified, the procedure has been to require the institution to purchase the promissory notes of the ineligible loans, which then become institutional receivables, and require repayment of all past interest and special allowance paid on the ineligible loans. Assigning the notes to the institution causes future interest and special allowance payments to cease, and prevents future default expense to the Department.

However, estimating the actual loss the Department (interest, special allowance, and defaults) rather than requiring purchase

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of ineligible Stafford and SLS Loans has several advantages. First, since there is no direct authority for requiring a school to purchase ineligible loans, assessing liabilities for the Department's estimated actual losses will be much more successful in administrative and judicial proceedings. It also allows the Department to establish a specific receivable amount, on which we can pursue collections, including use of the administrative offset procedure. Requiring schools to purchase ineligible loans means that each eligible loan must be identified. If the school refuses to cooperate or does not have complete records, this is sometimes a problem. The estimated actual loss calculation can be done using data from a statistically valid sample, because the calculation requires only the total liability amount. Finally, it should result in additional recoveries for the Department, since institutions are more likely to be able to pay estimated actual amount than to purchase an entire portfolio.

This actual loss formula make use of the information provided to the Department by all guarantee agencies on the annual "tape dump". The GSL Policy Branch calculated three figures from that information representing the average number of days from:

1. disbursement to repayment (the end of the grace period);
2. repayment to default;
3. repayment to paid-in-full.

Because of the differences between school types, these averages were calculated for three different school types:

1. proprietary
2. public/private two-year
3. public/private four-year

The average number of days is used in the formula to estimate the amount of interest and special allowance the Department will pay on the ineligible Stafford Loans for their entire life--past and future. Please note the following:

--Interest and special allowance is estimated from the date of disbursement up to the date on which the loans enter repayment, and special allowance only from that date until the loan is completely repaid or is transferred to the guarantee agency as a default claim.

--When calculating the special allowance costs from the date the loan entered repayment to the paid-in-full date, one-half the principal amount of the ineligible loans is used in the calculation to adjust for the declining principal balance of those loans over the years. Please see the attached worksheet for the actual calculation.

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The second part of the calculation estimates the total defaults on Stafford and SLS Loans, using the cohort default rate most appropriate for the review period. For example, if the ineligible loans were made in 1988 and entered repayment in 1989, the 1989 cohort default rate for the school is probably the most appropriate. More recent review periods may have to use the most recent cohort rate as the only available estimate. A different rate, or method, may be used if the reviewer has a better estimate of the default rate, but any other method must be discussed with IRB, Central Office before being used.

Attachment C gives a brief explanation of the formula. The language has been provided for you to incorporate into letters to schools explaining the process. The same language will be included on the printout produced by the actual loss software you will receive shortly.

The following procedure should be used to identify institutional liabilities for ineligible Stafford and SLS Loans. The actual loss formula is found on the attached worksheet.

PROCEDURE

A. Determine Appropriate Corrective Action:

The reviewer must make an evaluation of whether the actual loss formula is an appropriate corrective action for the situation. **This method should not be used in cases of unpaid refunds, unreturned loan checks for students who never attended the institution, fraud, or forgery.** As a guide, any situation in which it would be appropriate to allow the institution to purchase the promissory notes for the ineligible loans can also be appropriate for this method. **Questions about when to use this method should be referred to IRB, Central Office.**

B. Determine The Ineligible Loan Total:

When the reviewer identifies a violation at an institution that may have resulted in a substantial liability for ineligible Stafford or SLS Loans, the dollar amount of the ineligible loans should be determined in one of two ways:

- a. Require the institution to perform a file review of all student records to identify each ineligible loan (may require CPA certification); or,
- b. Require the institution to have a Certified Public Account review a statistically significant sample of files and certify the results. The percentage of ineligible loans in such a sample may be reliably extrapolated to the

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total of loans made by the institution. If a statistically significant sample shows a 15% rate of ineligibility, it is reasonable to assume that 15% of all the loans made by that institution were ineligible.

C. Complete The Actual Loss Worksheet:

If total ineligible loan amount is known (method "a"), enter the total principal amount of ineligible Stafford and SLS on Lines 4 and 5 of the worksheet. If extrapolating from a statistical sample (method "b"), enter the total principal amount of Stafford and SLS made in the review period on Lines 1 and 2, multiply by the error rate, and enter the results on Lines 4 and 5.

On Line 6, enter the cohort or other default rate most applicable to loans made during the review period.

Follow the instructions on the worksheet to calculate the Department's estimated actual loss for the ineligible loans. Steps 3 and 4 result in an estimate of the total interest and special allowance, past and future, for the ineligible Stafford Loans.

Step 2: Estimates the total default expense to the Department for the ineligible Stafford and SLS. Multiply the total of each loan type by the appropriate default rate.

Step 3: Estimates the total interest and special allowance paid on the ineligible Stafford Loans from the date of disbursement of each loan to the date the loan enters repayment. The interest and special allowance factor is multiplied by the average number of days between disbursement and the end of the grace period, according to guarantee agency information (by school type). The result is multiplied by the total ineligible Stafford Loan amount.

Step 4a: Estimates the total special allowance paid from the date each loan enters repayment until the date it defaults. The special allowance factor is multiplied by the average number of days between repayment and default, according to guarantee agency information (by school type). The result is multiplied by the total ineligible Stafford Loan amount expected to default (using cohort default rate information).

Step 4b: Estimates the total special allowance paid from the date each loan enters repayment until it is paid in full. The special allowance factor is multiplied by the average number of days between repayment and payment in full, according to guarantee agency information (by school type). The result is multiplied by one-half of the total ineligible Stafford Loan amount not expected to default.

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Using one-half of the total adjusts the calculation for the declining principal balance of the loans during the repayment period.

The results of Steps 2 through 4 are added together to obtain an estimate of the actual loss to the Department for the ineligible loans.

Note: The calculation shown on the worksheet has been simplified for use by creating a computer program that will perform the calculation automatically. The reviewer need only enter the school type, ineligible loan amount, and default rate. A diskette containing this program will be provided to each Regional Office within the next few weeks.

D. Contact IRB, Central Office

After the worksheet is completed, or if assistance is needed at any stage in the process, please contact IRB, Central Office. A Specialist will help you determine whether this method is appropriate, assist with the calculation, or, at your request, perform the calculation for you.

ATTACHMENT A
ESTIMATED ACTUAL LOSS WORKSHEET—STAFFORD/SLS LOANS

4/92 - Updated ISA

	Proprietary	Pub/Priv (2-yr)	Pub/Priv (4-yr)
1. Total Stafford Loans (review period)	\$_____	\$_____	\$_____
2. Total SLS (review period)	\$_____	\$_____	\$_____
3. Review Error Rate	_____%	_____%	_____%
4. Inelig Stafford (1 X 3)	\$_____	\$_____	\$_____
5. Inelig SLS (2 X 3)	\$_____	\$_____	\$_____
6. Cohort Default Rate (review period)	_____%	_____%	_____%
7. Average Days: disbur- sement to repayment	584	774	969
8. Average Days: repay- ment to default	418	498	619
9. Average Days: repay- ment to PIF	1659	1580	1712

Step 1--Calculate ineligible Stafford/SLS: If extrapolating the error rate, enter total Stafford for the review period on Line 1, SLS on Line 2, and the review error rate on Line 3. Multiply total Stafford/SLS by the error rate and enter the result on lines 4 and 5.

(Stafford) \$_____ X _____% X \$_____

(SLS) \$_____ X _____% X \$_____

Step 2--Pay estimated defaults: Enter the cohort default rate on line 6. Multiply ineligible Stafford/SLS by default rate.

(a) (Stafford) \$_____ X _____% X \$_____

(b) (SLS) \$_____ X _____% X \$_____

Step 3--Pay estimated subsidies from disbursement to repayment: Multiply the ineligible Stafford by daily ISA factor (.000247), then by the number of days on line 7 (average days from disbursement to repayment). \$_____ X .000247 X _____ days = \$_____

Step 4a--Pay estimated special allowance from repayment to default: Multiply the ineligible Stafford by the cohort default rate to get the ineligible loan amount expected to default. Multiply this amount by the daily special allowance factor (.0000273), then by the number of days on line 8 (average days from repayment to default).

\$_____ X _____% X .0000273 X _____ days = \$_____

Step 4b--Pay estimated special allowance from repayment to PIF: Subtract the result of Step 2 from total ineligible Stafford to obtain the ineligible Stafford not expected to default. Multiply one-half of the result by the daily special allowance factor (.0000273), then by the number of days on line 9 (average days from repayment to paid in-full).

½[\$_____ - \$_____] X .0000273 X _____ days = \$_____

Step 5--Determine total estimated liability: Add the totals in steps 2(a), 2(b), 3, 4(a), and 4(b).

\$_____ + \$_____ + \$_____ + \$_____ + \$_____ = \$_____

ATTACHMENT B - REGIONAL COMMENTS

A copy of the regional comments is not included in this electronic version. To obtain a hardcopy, contact the Performance Improvement and Procedures Division at (202) 708-8197.

MEMORANDUM

UNITED STATES DEPARTMENT OF EDUCATION

WASHINGTON, D.C. 20202-_____

JUL 17, 1996

TO: All Regional Directors and Institutional Review Branch Chiefs

THROUGH: Bonnie LeBold, Director, ROD
Howard Fenton, Director, IMD

FROM: Shirley Brown, Acting Chief, IRB/IMD

SUBJECT: Estimated Actual Loss Calculations

As many of you know, the Department's formula for determining its estimated actual loss on ineligible Stafford and SLS loans is playing an increasingly prominent role in administrative hearings involving program review and audit review determinations.¹ Several opinions recently issued by hearing officials suggest that the Department must use estimated actual loss in ineligible loan cases,² or that where the Department considers purchase of ineligible loans from the holders to be the proper remedy for noncompliance by the school rather than payment of the estimated actual loss on those loans, the Department should do so pursuant to standards for making this decision and should conduct an analysis to justify the choice.³ In response to this increased attention, IRB Headquarters has begun to work with other Departmental offices to consider possible revisions to the estimated actual loss formula so that the formula fully and accurately reflects the government's true costs on ineligible loans. However, since it may be some time before a new version of the estimated actual loss formula can be developed and disseminated, IRB Headquarters has prepared this memorandum to provide guidance on using the existing formula most effectively. This memorandum supplements existing IRB policy on estimated actual loss, as reflected primarily in IRB Procedure Memo 92-3.

The discussion here will be divided into two parts. The first portion will focus on questions that have arisen concerning the existing formula. The second section will

¹ By using the estimated actual loss formula, the past and future financial damages to the government caused by school errors with regard to loans are calculated based on reasonable estimates of the net cost to the government of payments that have and will be made on those loans, and recovery of those damages is demanded from the school. In contrast, requiring the school to purchase ineligible loans attempts to transfer from the government to the school the financial risk of future default and interest rate subsidy.

² *In the Matter of Morgan Community College*, 94-152-SP. The case suggests that the only reason the Department might fail to apply actual loss is to penalize the institution.

³ *In the Matter of Nettleton Junior College*, 93-29-SP. The administrative tribunal ruled that the liability owed by the school would be determined by using the estimated actual loss formula on the grounds that the FPRDL contained "no findings and no analysis to justify the choice made to deny Nettleton's request for application of the Actual Loss Worksheet." The *Nettleton* case was affirmed by the Secretary on February 28, 1995.

address IRB policy on the situations in which estimated actual loss⁴ is to be employed, rather than requiring loan purchases.

Existing Estimated Loss Formula

First, it has come to my attention that a few regional offices are still using the incorrect estimated loss factors set forth in IRB Procedure Memo 92-3, rather than the updated version of the formula distributed April 20, 1992. Naturally, all regional offices should ensure that estimated loss calculations are done using the most current version of the formula. The current Interest and Special Allowance (“ISA”) daily factor -- used in Step 3 of the formula -- is .000247, which works out to an annual rate of 9%. The current Special Allowance (“SA”) daily factor -- used in Steps 4(a) and 4(b) of the formula -- is .0000273. This equates to a 1% annual factor. As always, reviewers should feel free to contact IRB Headquarters with any questions concerning these factors or any other aspect of the estimated loss formula.

Next, the current version of the estimated loss worksheet contains one line for the reviewer to enter the amount of ineligible Stafford loans and another line for the reviewer to enter the amount of ineligible SLS. For the purposes of the worksheet, unsubsidized Stafford loans and PLUS loans should be treated as SLS loans. Thus, to determine the amount of ineligible Stafford loans for estimated loss purposes, the reviewer first needs to distinguish subsidized Staffords from unsubsidized Staffords. The line in the worksheet for ineligible Stafford loans is used only to enter the amount of ineligible *subsidized* Stafford.

Another common question concerning the estimated loss worksheet involves determining which default rate is used in the calculations. Current IRB/IMD guidance on this topic indicates only that the calculations should be based on the “most appropriate” cohort default rate (“CDR”). This ambiguity created some inconsistency both between and within the regional offices. For instance, one regional office might use the institution’s most recent cohort default rate, while another might use an average of the institution’s three most recent cohort default rates. In the interest of creating a consistent national approach on this matter, IRB is now adopting the policy that the reviewer should use the cohort rate for the period under review whenever possible. Naturally, though, this will often not be feasible given the timing of the publication of the CDRs. By way of alternative, then, the reviewer should use the institution’s most recent cohort default rate.⁵ The most recent cohort default rate is generally the best available estimate of future default activity for that

⁴ For the remainder of this memorandum, the estimated actual loss formula will be referred to as simply “estimated loss” or “the estimated loss formula.” The term “actual loss” is also sometimes used to describe this formula; however, “estimated loss” is more accurate because the formula only really provides an approximation of the government’s true losses, not an exact calculation.

⁵ The fact that the particular default rate employed in the calculations happens to be under appeal is irrelevant. The appeal of a final CDR defers termination of participation in the loan programs for the duration of the appeal, 34 C.F.R. § 668.17(b)(6), but the Department otherwise treats the published final CDR as in effect despite the filing and pendency of an appeal.

institution. Furthermore, using a different default rate, such as the institution's highest default rate or a three-year average default rate, could be subject to attack on the grounds that the institution has been undertaking efforts to reduce its CDR so that future defaults will not be so high.

Policy on Use of Estimated Loss

IRB Headquarters has also received a number of inquiries from the regional program review staff concerning the situations in which it is appropriate to utilize the estimated loss formula. I will now offer some specific guidelines for reviewers in deciding whether or not to utilize estimated loss.

The general rule is that estimated loss is used in lieu of requiring an institution to repurchase ineligible Stafford or SLS loans. "Ineligible loans" typically refers to loans that were issued to ineligible borrowers; however, it can also mean loans made to eligible borrowers in excess of the permissible amounts.⁶

Notwithstanding the general rule, there remain a number of situations where application of estimated loss is inappropriate. Specifically:

- ◆ The estimated loss formula should never be used in cases where the reviewer knows that all of the loans in question are currently in default. In these situations, requiring the school to purchase the loans is appropriate because the loss to the government is known or easily discernible; there is therefore no need to obtain an estimate of the government's loss.

Following the above logic, if the reviewer has a universe of 30 ineligible loans, all of which are known to be already in default, estimated loss would not be used. However, if the reviewer has a universe of 30 loans, only some of which the reviewer knows to be in default, estimated loss would be used.⁷ In the second situation, the Department assumes that the losses from the known defaults will be adequately computed and satisfactorily recouped as part of the estimated loss liability.

- ◆ The estimated loss formula should not be used in situations where the students in question may be eligible for loan relief. Thus, the estimated loss formula should not be used in cases where the student borrowers may qualify for a false certification

⁶ Observe the distinction between an ineligible amount or loan, and an amount in excess of the limits on subsidy. Amounts in excess of the limits on subsidy are not necessarily ineligible loans if the student would have been eligible for an unsubsidized loan in that amount.

⁷ Still, if the amount of loans that are known to be already in default exceeds the amount of estimated default costs as projected under the estimated loss formula, estimated loss, because it rests on generalized projections, may understate the net costs that will be incurred on that particular cohort of loans. In this situation, the reviewer should consult with IRB Headquarters to consider whether to require loan purchase.

- ◆ discharge under 34 C.F.R. § 682.402(e). Likewise, estimated loss should not be used in cases where borrowers may qualify for a Closed School Loan Discharge under 34 C.F.R. § 682.402(d) or 34 C.F.R. § 685.213. In these cases, the Department absorbs the full cost of the ineligible loan without regard to whether the loans are in default, including the cost of reimbursing the borrower for any amounts already repaid by or recovered from the borrower. The Department thereby acquires a claim against the school for the full amount disbursed on the loan, and seeks recovery of that full amount, not merely its default costs.
- ◆ The estimated loss formula is inapplicable to refund situations because refunds are made on a student-specific basis and cannot be satisfactorily addressed via a lump-sum payment to ED.⁸
- ◆ Estimated loss may be inappropriate in cases where it appears that the institution is certifying loans that it *knows* are ineligible. The concern here is that an institution, aware that the Department typically applies the estimated loss formula to ineligible loans, may proceed to certify ineligible loans believing that it will be held accountable for only a fraction of the amount disbursed on these ineligible loans. By way of illustration, IPD recently handled a case involving a school that had previously been charged with certifying loans for students who were not enrolled on at least a half-time basis and were therefore ineligible to receive them. That finding -- and the resulting liability computed using the estimated loss approach -- was upheld on appeal by an ED hearing official; nevertheless, even after that ruling, the school continued to certify loans to these students. IPD did not use estimated loss to remedy this post-appeal misconduct, because IPD concluded that the school continued this violation of program requirements in the belief that the financial consequences of that misconduct were minimal when computed solely on net default costs.⁹

If the reviewer determines that an institution is knowingly certifying ineligible loans, the reviewer should first consider recommending the institution for a fine, limitation, or termination action. In addition, though, the Department may opt not to apply estimated loss to the program review liabilities. The reviewer should consult IRB Headquarters to determine the best course of action.

Having identified a number of situations where estimated loss should not be used, I will also specify one situation in which estimated loss must *always* be used. In any case that involves a projection from a statistical sample, estimated loss must be used. In this situation, the Department does not know which specific students received ineligible loans;

⁸ Of course, ISA should still be recouped in cases involving late or unmade refunds. To calculate ISA in the refund situation, the reviewer should use the ISA Worksheet prepared by Marvin Weindorff of Region IV. Note, though, that Marvin's worksheet can be used only on *subsidized* Stafford loans; do not use the worksheet to calculate ISA on unsubsidized Stafford or SLS loans. Furthermore, be advised that the ISA worksheet is updated regularly; as of the date this memorandum was issued, the most current version of the worksheet is entitled "isa42396.xlt".

⁹ This IPD action has not yet been tested by the school through an administrative or court appeal.

therefore, instructing the school to purchase the loans would not be feasible and estimated loss is the only realistic alternative.

The previous discussion has identified situations where estimated loss should not be used as well as a situation where it would always be used. However, there will of course be a number of cases that do not fall squarely within the above categories. In such situations, reviewers should follow the following guidelines. If 10 or fewer ineligible loans are involved, estimated loss will not be used. When such a relatively small number of loans is involved, estimates of subsidy and default costs based on generalizations may be significantly less reliable as estimates of costs with respect to these particular loans, and purchasing the loans is not overly burdensome to the institution. Furthermore, by purchasing the loan from the holder, the school acquires the right to collect the loan from the student; over time, then, the burden to the school is not the purchase price of the loans, but rather the portion of the loans not collected.

Conversely, if 11 or more ineligible loans are involved, the reviewer should apply the estimated loss formula. As the number of ineligible loans increases, the burden to the school in identifying and purchasing all ineligible loans increases, as does the burden to the Department of monitoring and enforcing compliance with that demand, so it is reasonable to apply estimated loss.

Because the Department continues to demand in a variety of situations that institutions purchase ineligible loans from the current holders, there is a need to establish a consistent policy for calculating the interest and special allowance payable to the Department on these loans. Some of the review staff have been trying to utilize the ISA worksheet, developed by Marvin Weindorff to calculate ISA on late or unmade refunds, to also calculate ISA on loans that are being purchased by the institution. However, although Marvin's worksheet does function well in the refund arena, it tends to underestimate the interest and special allowance owed to the Department on purchased loans. This is true primarily because it fails to consider the interest and special allowance paid by the Department during the period from disbursement to repayment.¹⁰ Accordingly, Marvin's ISA worksheet should not be used for calculating interest and special allowance on loans that are being purchased by the institution.

OGC has suggested an alternative approach for calculating ISA in the purchase context which is hereby adopted as IRB policy. To determine ISA payable to the Department on subsidized loans that are being purchased, the reviewer should multiply the amount of ineligible loans disbursed by the daily ISA factor from the estimated loss worksheet (.000247), and then multiply this total amount by the appropriate average number of days from disbursement to repayment.¹¹ This provides an estimate of the ISA the Department

¹⁰ In fact, there is not even a field in Marvin's worksheet to enter the disbursement date.

¹¹ The average number of days varies depending on the type of institution. For a proprietary school, the number is 584 days; for a 2-year public or private institution, 774; for a 4-year public or private institution, 969. Furthermore, if the reviewer knows the date that the ineligible loan was disbursed and the

would have paid, based on historical data, for the subsidized period. The school should be advised that it may investigate the particulars of the situation and determine a more precise figure. Also, to be fair, the above method should be used only if the loan has already entered repayment; if not, the reviewer should follow the same general procedure except that the average number of days from disbursement to repayment should be replaced by an exact tally of the number of days from disbursement to the issuance of the FPRD.

The above process should be used only for *subsidized* Stafford loans. For unsubsidized Stafford, SLS, or PLUS loans that are being purchased, the reviewer should multiply the amount of ineligible loans disbursed by the daily SA factor from the estimated loss worksheet (.0000273), and then multiply this total amount by the appropriate average number of days from disbursement to repayment. This provides an estimate of the SA paid by the Department from disbursement of the ineligible loan to the time that the loan enters repayment. Because the Department does not pay interest subsidies on these types of loans, special allowance is the only money recovered directly from the school by ED.¹²

Finally, some reviewers have inquired as to whether the estimated loss formula also applies to Direct Loans. While the formula was specifically designed for use with ineligible *FFEL* loans, there is no reason in theory why the formula should not also apply to schools participating in Direct Lending. However, some modifications to the formula may be necessary before it can be used with Direct Loans; the SA factor, for example, would need to be set to "0" for Direct Loans. Accordingly, for the time being, reviewers should contact IRB Headquarters before performing any estimated loss calculations involving Direct Loans.

Thank you for your time and attention to this memorandum. Please feel free to contact Kenneth Hyde or Jesus Moya of my staff at (202) 708-8701 if you have any questions.

cc: Mary K. Muncie, Deputy Director, ROD
Harold Jenkins, Assistant General Counsel, OGC
Angelean Torruella, Acting Chief, ARB/IMD
Fred Marinucci, OGC
Steve Kraut, OGC
Phil Brumback, ROD
Mary Gust, IMD
IRB/IMD Staff

date the loan entered repayment, the reviewer should use the exact number of days from disbursement to repayment instead of the aforementioned averages.

¹² Under this option the school purchases defaulted loans from the guarantor by paying the guarantor the outstanding balance on the loan; that amount includes accrued interest, a portion of which the Department reimbursed the guarantor under the reinsurance agreement. Payment by the school to the guarantor to purchase the loan would be remitted by the guarantor to the Department, as would reinsurance payments received with regard to a loan later repurchased by a lender.